OpCost

MOORE STEPHENS

Future operating costs report

October 2018

Shipping

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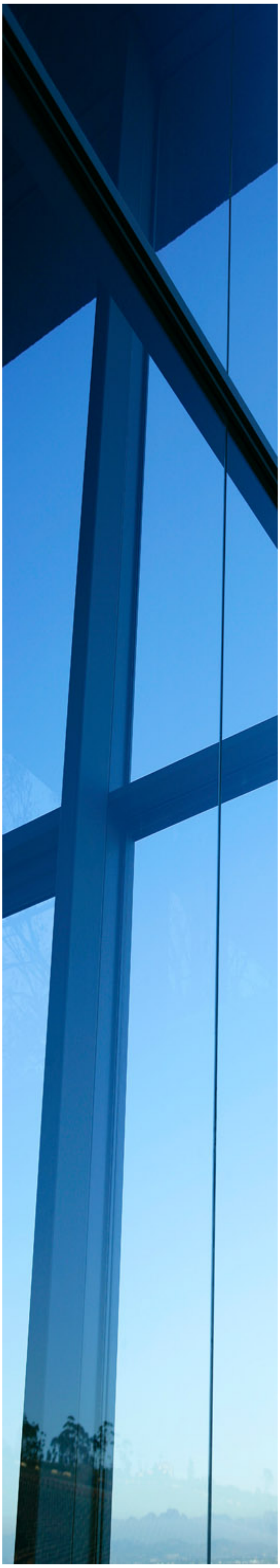


Contents

1 Results

Vessel operating costs are expected to rise by 2.7% in 2018 and by 3.1% in 2019, according to our latest survey.

Key findings

Responses to the survey revealed that drydocking is the cost category likely to increase most significantly in both 2018 and 2019, accompanied in the latter case by repairs and maintenance.

The cost of drydocking is expected to increase by 2.1% in 2018 and by 2.3% in 2019, while expenditure on repairs and maintenance is predicted to rise by 2.0% in 2018 and by 2.3% in 2019.

The increase in expenditure for lubricants is expected to be 1.9% in 2018 and 2.1% in 2019. Meanwhile, projected increases in spares are 1.9% and 2.2% in the two years under review, while those for stores are 1.6% and 1.9% respectively.

The survey revealed that the outlay on crew wages is expected to increase by 1.3% in 2018 and by 1.9% in 2019, with other crew costs thought likely to go up by 1.5% in 2018 and by 1.8% in 2019.

The cost of hull and machinery insurance is predicted to rise by 1.3% and 1.6% in 2018 and 2019 respectively, while for protection and indemnity insurance the projected increases are 1.2% and 1.4% respectively. Management fees, meanwhile, are expected to increase by1.0% in 2018, and by 1.2% in 2019.

The predicted overall cost increases were once again highest in the offshore sector, where they averaged 4.1% and 4.2% respectively for 2018 and 2019. By way of contrast, predicted cost increases in the bulk carrier sector were 1.8% and 2.6% for the corresponding years.

Operating costs for tankers, meanwhile, are expected to rise by 2.4% in 2018, and by 2.9% the following year, while the corresponding figures for container ships are 4.2% and 3.8%.

Cost type (mean)	2018	2019
	%	**%**
Crew wages	1.3	1.9
Other crew	1.5	1.8
Lubricants	1.9	2.1
Stores	1.6	1.9
Spares	1.9	2.2
Repairs & maintenance	2.0	2.3
H&M insurance	1.3	1.6
P&I insurance	1.2	1.4
Management fees	1.0	1.2
Dry docking	2.1	2.3
Total operating costs	**2.7**	**3.1**

Respondents to the survey highlighted various areas of concern likely to result in increased operating costs over the next two years. Regulation was high on the list, with one respondent noting: “New regulations will lead to extra costs for all owners, for example the Ballast Water Management Convention and IMO’s 0.50% global limit on the sulphur content of fuel oil used on board ships.” Another emphasised: “New regulations will be detrimental to future operating costs.”

On the subject of crew costs, one respondent said, “We do not expect any major variations in 2019. Basic crew wages for Filipino seafarers, however, will come under review in this period, and we may see some increase there.”

Fuel costs were referenced by a number of respondents. “The cost of fuel treatment equipment will increase in the next two years,” said one, while another remarked, “The Sulphur 2020 Rules will have a significant impact on fuel costs.” Elsewhere it was noted that bunker prices are volatile, with overall increases reported of between 28% and 42%.

One respondent noted, “Maintenance in general has been somewhat on hold, and we will see a correction in that in 2018 and 2019,” while another said, “We will see an increase in costs for automation and communications, not least because electronics have a shelf life.”

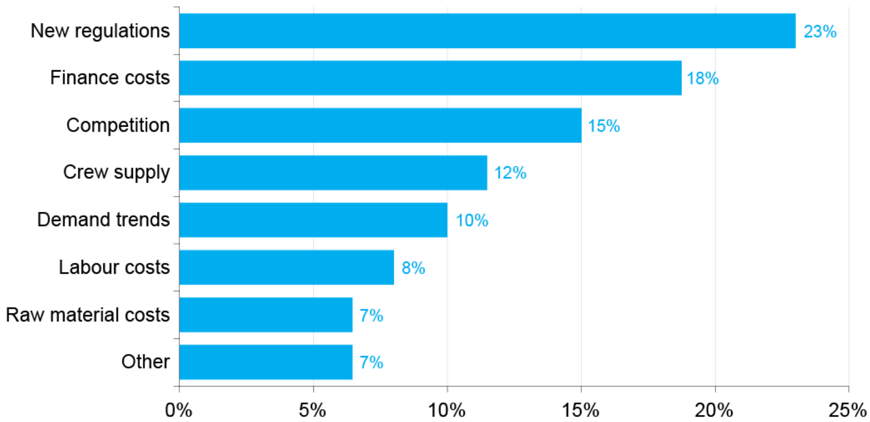
On a more general level, respondents voiced concerns about environmental issues, trade wars, the cost of securing finance, and the global economic recession, all of which were perceived to have the potential to result in increased operating costs.

Factors influencing operating costs

We asked respondents to tell us about the factors that would most affect operating costs, by asking the following question: Which three of the following factors will most influence the level of vessel operating costs over the next 12 months? Please rank your three chosen factors in order of priority (1, 2, 3).

Overall, the cost of new regulation was identified as the most influential factor likely to affect operating costs over the next 12 months, at 23%, up from equal third place at 15% last year. 18% of respondents identified finance costs in second place, down from 20% and first place last year. Competition ranked in third place at 15% as it had last year. Meanwhile crew supply, fell to 12% compared to 19% and second place in last year's survey.

Most influential factors on vessel operating costs over the next 12 months



Conclusions

The predicted 2.7% and 3.1% increases in operating costs for 2018 and 2019 respectively compare to an average fall in actual operating costs in 2017 of 1.3% across all main ship types recorded in the recent Moore Stephens OpCost study.

One year ago, expectations of operating cost increases in 2018 averaged 2.4%, so the increase now in that expectation to 2.7% must be regarded as sobering – if not unexpected – news. Projected increases in operating expenditure are part and parcel of the workings of any industry, and must be factored into budget projections. But these latest predicted increases, whilst a cause for concern, should not unduly surprise or concern shipping, an industry which has seen – and in many cases endured – much larger increases during the past decade.

New regulations were included this year for only the second time in the life of the survey among the list of factors which respondents could cite as most likely to influence the level of operating costs over the next 12 months. This has proved to be a timely addition, with 23% of respondents citing new regulation as an influential factor, ranking it in first place. The Ballast Water Management Convention (BWM) and Sulphur 2020 are the major items on the list of incipient shipping legislation, but the industry is becoming more tightly regulated generally in terms of both safety and environmental responsibility, so compliance with evolving national and international regulation is likely to remain a significant item in operating cost analyses and projections for the foreseeable future.

The fact that drydocking emerged as the cost category likely to increase most significantly in both 2018 and 2019 is unsurprising, given the need to comply with the existing and emerging regulatory framework within which the industry is being obliged to operate. The same may be said of repairs and maintenance, where any previous delay in attending to items of a non-critical nature will need to be addressed.

Estimates relating to the likely increase in the cost of lubricants over the two-year period, meanwhile, are towards the higher end of the survey scale, which is in line with a predicted rise in oil prices this year and next.

Expected increases in the price of hull and machinery insurance are up on estimates made 12 months ago but, due to the highly competitive nature of the market, cannot be regarded as an entirely reliable bellwether. Estimates of protection and indemnity cost increases are also up, perhaps reflecting increased management costs and the possibility that the market's recent benign large-claims experience may not be repeated over the next couple of years.

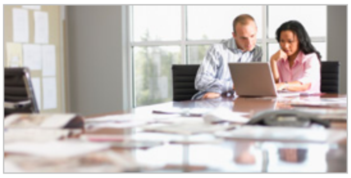
Elsewhere, there were some interesting predicted cost increases in the individual market sectors. The offshore industry, for example, is predicted to be facing increases of 3.1% in repairs and maintenance for 2019, compared to the 1.9% predicted for tankers. Indeed, the offshore sector is expected to face the biggest increases in operating costs in 2019 in every category of expenditure covered by the survey.

One could argue that the level of predicted operating cost increases for 2018 and 2019 ought to be manageable in a competitive, viable industry environment. Nobody doubts shipping's essentially competitive nature, but the issue over viability is less clear-cut.

Shipping has held up well during a ten-year economic downturn, and investors continue to express confidence in the industry's potential for profit. Sadly, some good companies have gone to the wall over the past decade but, overall, the industry has become leaner by virtue of having let market forces function as they should. Yet market intelligence and common sense suggest that freight rates still need to improve significantly in order for shipping to start making the sort of money it should command in light of the vital role it plays in international trade and commerce.

The more money that shipping makes, the more comfortably it can meet its operating expenses. Increases in operating costs must be expected, and budgeted for. Those costs may change in nature, because new technology is already helping to reduce outgoings in some areas, while on the other side of the coin there is the evident need for technological investment to combat the likes of cyber-crime.

There are more *Ifs* involved in the shipping industry than there are in Kipling's poem. If freight rates go up, if world trade increases, if political tensions and trade wars allow, if China continues to flourish, if oil prices rise, if stock markets hold their nerve, if Brexit means Brexit, if Brexit means something else, then shipping will be in a position to reap the benefits. It will require good management, good judgement, good research, good advice and good luck. And it will require good husbandry. As Benjamin Franklin said, "Beware little expenses, a small leak will sink a great ship."

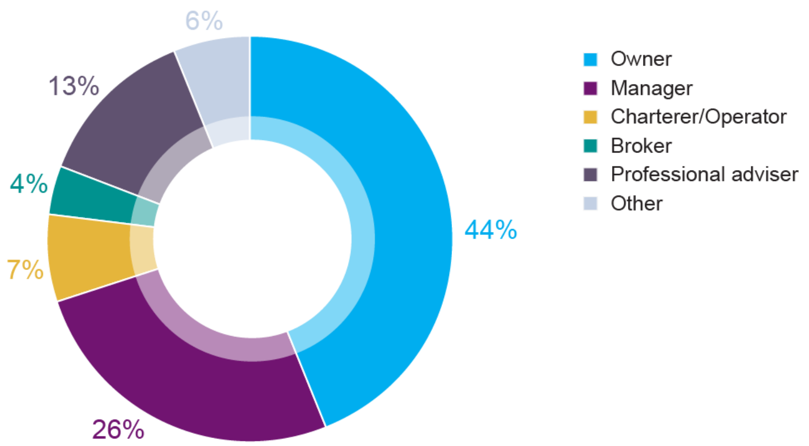


2 Respondent details

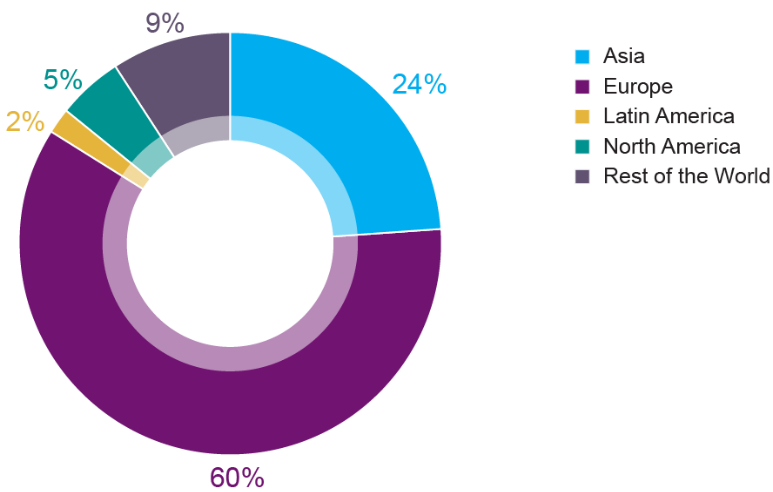
We contacted key players in the shipping market internationally over a 28 day period in September 2018, asking them to complete a short web-based questionnaire so that they could share their views with us.

We are extremely grateful to those who responded. We asked respondents to provide information on their business type, headquarters' location and sector most relevant to their operations to help us analyse the responses.

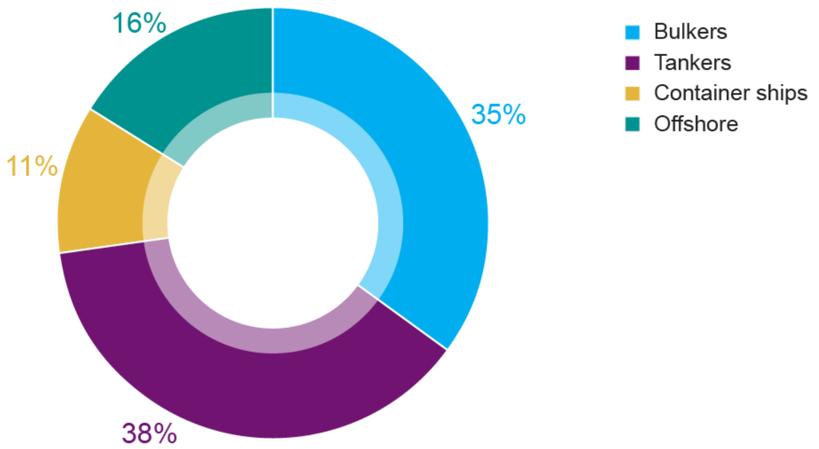
Business type



Headquarters' location



Sector



Our commentary on the survey relates to statistics derived from the responses received. We believe the respondents represent a cross-section of the industry and, therefore, that our analysis is a good representation of the shipping industry as a whole, but it is not possible to guarantee that this is the case.

3 About Moore Stephens

With over 80 years' experience in the shipping industry, Moore Stephens is widely acknowledged as one of the world's leading shipping accountants and advisers.

In our long association with the shipping industry, Moore Stephens has accumulated an unparalleled depth of knowledge and breadth of worldwide experience. That knowledge is demonstrated by the fact that the net book value of vessels audited in London exceeds US$20 billion and that we act for over 2,000 ships internationally and have member firms in all of the principal shipping locations throughout the world.

We advise a wide range of clients from large multinational corporations to single vessel owners, including:

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- Cruise operators
- Hedge funds
- Logistics operators
- Maritime organisations
- Operators
- Owners
- P&I clubs (insurers)
- Port agents
- Ports
- Private equity
- Ship brokers
- Ship managers
- Shipping funds
- Shipping pools

We also publish OpCost, a unique annual benchmarking tool for all major vessels' operating costs, currently featuring 26 vessel types. OpCost allows users to benchmark and compare vessel running costs with the industry average and identify cost saving areas.

We help clients thrive in a changing world.

We provide all the support and guidance you need to deal with new risks and opportunities. We ensure easy access to the right people, so decisions can be made quickly and confidently. A consistent team will partner with you to support your aspirations and contribute to your success.

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If your business and personal interactions need to expand, we'll help make it happen – coordinating advice from a network of offices throughout the UK and in more than 100 countries.

For more information about Moore Stephens visit:
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Appendix 1: Cost increase data by sector

Cost increase data by sector (Bulkers, Tankers, Container Ships and Offshore) for both 2018 and 2019 is provided in the tables below.

Expected cost increases for year ending 31 December 2018					
Mean	**Bulkers**	**Tankers**	**Container Ships**	**Offshore**	**Total**
	%	%	%	%	%
Crew wages	1.2	1.4	1.2	1.8	1.3
Other crew	1.4	1.4	1.9	1.8	1.5
Lubricants	1.9	1.5	3.1	2.2	1.9
Stores	1.6	1.2	2.2	2.2	1.6
Spares	2.2	1.4	2.5	2.1	1.9
Repairs & maintenance	2.0	1.5	2.7	2.9	2.0
H&M insurance	1.5	0.9	0.5	2.4	1.3
P&I insurance	1.1	1.0	0.0	2.5	1.2
Management fees	1.0	0.9	0.5	1.9	1.0
Dry docking	1.7	2.1	2.6	2.6	2.1
Total costs	**1.8**	**2.4**	**4.2**	**4.1**	**2.7**

Expected cost increases for year ending 31 December 2019					
Mean	**Bulkers**	**Tankers**	**Container Ships**	**Offshore**	**Total**
	%	%	%	%	%
Crew wages	1.8	1.7	2.1	2.4	1.9
Other crew	1.6	1.5	2.1	2.5	1.8
Lubricants	2.2	1.9	2.2	2.4	2.1
Stores	1.9	1.5	2.2	2.6	1.9
Spares	2.4	1.7	2.5	3.0	2.2
Repairs & maintenance	2.3	1.9	2.5	3.1	2.3
H&M insurance	2.0	1.2	1.1	2.3	1.6
P&I insurance	1.4	1.2	1.0	2.2	1.4
Management fees	1.2	1.1	0.5	1.9	1.2
Dry docking	2.1	2.2	2.6	3.1	2.3
Total costs	**2.6**	**2.9**	**3.8**	**4.2**	**3.1**

Moore Stephens LLP, 150 Aldersgate Street, London EC1A 4AB
T +44 (0)20 7334 9191
www.moorestephens.co.uk

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